

Washington State Auditor's Office
Accountability Audit Report

**Grays Harbor Public Development
Authority**
Grays Harbor County

Audit Period
January 1, 1999 through December 31, 2000

Report No. 63315

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Washington _____
State Auditor

Brian Sonntag

Audit Summary

Grays Harbor Public Development Authority Grays Harbor County January 1, 1999 through December 31, 2000

ABOUT THE AUDIT

This audit report contains information from our review of the Grays Harbor Public Development Authority for the period January 1, 1999, through December 31, 2000.

We performed audit procedures to determine whether the Authority complied with state laws and regulations and its own policies and procedures. Our work focused on specific areas that have a potential for abuse and misuse of public resources.

RESULTS

During the audit, our first of the Authority, we found that the Authority did not comply with state laws regarding the conduct of business by local governments in several areas including:

- State bid laws
- Loaning of the Authority's credit
- Expenditures
- Investments
- Compensation to employees

These conditions are discussed in detail later in this report. Other issues noted during the audit were communicated to Authority management. We appreciate the Authority's commitment to resolve the issues.

During the audit we did note the Authority had good internal controls over cash receipts, billing and accounts receivable. The Authority was also in compliance with the Open Public Meetings Act requirements.

RELATED REPORTS

Our opinion on the Authority's financial statements and compliance on federal requirements is provided in a separate report dated October 31, 2001, which includes the Authority's financial statements. In the report, we disclose the Authority's financial statements were fairly stated and were in compliance with federal grant requirements.

CLOSING REMARKS

We appreciate the Board Members' strong interest and active involvement in communicating the results of the audit, as it is vital for promoting accountability, fiscal integrity and openness in local government. We thank the newly appointed Chief Executive Officer for requesting the performance of the Authority's first audit and the Authority's officials and personnel for their assistance and cooperation during our audit

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Grays Harbor County
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Description of the Authority

Grays Harbor Public Development Authority Grays Harbor County January 1, 1999 through December 31, 2000

BACKGROUND

Public Development Authorities

In 1985, the Washington State Legislature gave local governments the authority to establish "public corporations, commissions or authorities." These entities have become known as Public Development Authorities, or PDAs.

PDAs are created to administer federal grants or programs, to improve governmental efficiency and services and/or to promote economic development. They have been established in communities across the state to oversee everything from public markets to housing projects.

In general, laws that apply to the local governments creating a PDA also apply to the PDA. Additionally, the entities that create the PDA are not liable for its debts, should any occur. Any liabilities incurred are to be satisfied by the sale of assets and properties of the PDA.

State law specifically gives the State Auditor's Office the authority to audit PDAs.

PDA Response

The Grays Harbor Public Development Authority (GHPDA) notes that the Auditor's Office has included the following statement in the background portion of the Audit report:

"Laws that apply to the local governments creating a PDA also apply to the PDA."

The GHPDA would very much appreciate clarification on the issue as set forth above. The GHPDA has operated with the understanding that RCW 35.21.730 through RCW 35.21.759 control the actions of Public Development Authorities. The GHPDA notes for example that RCW 35.21.747 establishes a procedure for sale or encumbrance of PDA real property that differs from that set forth for counties under RCW 36.34. There are several instances where clarification of powers and authorities, both general and specific, would be very helpful to not only the Grays Harbor PDA but to PDAs throughout the state. The GHPDA desires to work with the Auditor's Office and any other parties, towards clarification and resolution of this issue.

ABOUT THE AUTHORITY

In 1998, the Grays Harbor County Commission, the Grays Harbor Public Utility District and the Port of Grays Harbor signed an agreement creating the Grays Harbor Public Development Authority. The Authority began operations in 1999. It is the successor organization to the Satsop Redevelopment Project, which was organized to examine the economic potential of the site of the never-completed Washington Public Power Supply System's (WPPSS) Satsop nuclear plant.

The Authority was organized to facilitate the redevelopment of the Satsop site. In a series of transactions in 1999, the Authority gained title to the land, roads and other site improvements from the Bonneville Power Administration (BPA), which took over management of the property from WPPSS after the system's bond default. By the end of 1999, the BPA had paid a total of

\$15 million in seed money to the Authority to help it develop the property as a business park. The BPA paid the Authority an additional \$10.75 million in 2000 for site restoration, demolition and clean up. The site work has been completed. The PDA does not have the authority to levy property taxes.

Since its inception, the Authority has spent about \$4 million to build a telecommunications infrastructure in an effort to attract high-tech clients. The Authority also made improvements to buildings, roads, and water and sewer systems at a cost of approximately \$10 million.

The site covers about 1,600 acres. It has several finished buildings that have more than 300,000 square feet of warehouse space, 130,000 square feet of office space, a telecommunications center and a 500,000 square foot turbine building.

Twenty-one businesses are now located at the site. The primary clients are SafeHarbor Technology Corp., Boise Cascade Corporation and Duke Energy Grays Harbor.

PDA Response

As a point of clarification, we appreciate the opportunity to restate that the PDA is a public corporation, not a municipal corporation, and as such has no taxing authority and receives no state or local tax dollars other than what may be received in the form of a grant or a loan from a specific program for which we may be eligible. We receive no direct tax dollars from Grays Harbor County, the State of Washington, or the federal government. With regard to funds that were originally received by the PDA, we would like to clarify what occurred. In August of 1999 the PDA took ownership of the site and received \$15 million from BPA to create a business park at Satsop. At a later date, BPA gave the Authority \$10.75 million for site restoration, demolition, and clean-up, because under the terms of the Site Transfer Agreement, BPA was responsible for this work. In the end however, BPA chose to have the PDA do the work directly, and funded it under a separate agreement signed in 2000. A summary of how the BPA funds were spent is as follows:

- *\$10.75 million investment in site cleanup and demolition, funded by BPA*
- *\$3 million-plus in telecom investment (including fiber optics)*
- *\$8 million-plus in building remodel or new construction*
- *\$3 million in infrastructure improvements – 2 road projects, new chlorinator building for water plant, sewer treatment plant, other utility improvements to serve tenants*

Currently, the Park has 27 leases, and an on-site workforce of 400-plus employees, which does not include the construction workforce of another 400 to 500 workers on-site. When the Boise Cascade plant is finished, another 125 jobs will be added to the Park. Completion is scheduled for this fall.

SafeHarbor

The Authority's first client was SafeHarbor Technology Corp. In 1999, the web-based, customer and technical support company signed a 20-year lease for an existing office building (now referred to as SafeHarbor #1) in which it agreed to pay \$1.44 per square foot of leased space, or more than \$68,800 per month.

In April 2000, the Authority agreed to construct another building for the company for lease payments of \$68,800 per month plus operating expenses of \$7,175, all with a 3% escalation clause each year. The final lease agreement was signed in August 2001 after several revisions. The Authority secured a \$4.5 million long-term mortgage loan from the U.S. Department of Housing and Urban Development that allowed it to pay off a private construction loan it had guaranteed for the company constructing Building 2. The PDA assumed the loan when it exercised the option to purchase the completed building.

SafeHarbor occupied the second building from November 2000 through March 2001. As part of a new lease renegotiated to help SafeHarbor with its cash flows, the Authority agreed to finance the disputed rent, a total of \$164,000. The Authority received an initial payment of \$50,000 and agreed to finance the balance over the next 12 months. However, the balance was paid in full in January of 2002. The second building is currently unoccupied. SafeHarbor and the Authority are working to find a new tenant for Building 2, however, SafeHarbor is still liable for and is making the required lease payments of \$70,864 plus \$6,488 in operating expenses.

At the end of 2001, SafeHarbor owed the Authority more than \$1.5 million under the terms of a separate lease agreement involving furniture, fixtures and equipment. An agreement signed in January 2002 sets new conditions for repayment. SafeHarbor is to make interest-only payments of \$5,700 a month through June 2003, when the company must pay the balance. The original agreement called for the balance to be paid by January of 2004.

PDA Response – SafeHarbor

SafeHarbor Technology Corporation became a tenant at the former Satsop Nuclear Power Plant site in November of 1998, prior to the PDA's arrival on site. At that time, the company leased 5,000 sq. ft. of space in a corner of what was then the Construction Office Building, which was occupied by WPPSS. Over the course of the next year, the 48,000 sq. ft. building was renovated in a project that was begun by the PUD, Port and County (the SRP) and finished by the PDA. A revised lease was signed in 1999 with the PDA when the building renovation was completed. Rent was set at \$1.44/sf/month, escalating each year for the 20 year term. Current rent for 2002 is \$1.49/sf/mo. or approximately. \$71,000/mo. This rent includes base rent, tenant improvement repayment, and operating expense. Through first quarter 2002, SafeHarbor Technology Corporation has paid approximately \$6.175 million to the PDA in rent and fees since establishing tenancy at the Park.

SafeHarbor started with six employees at Satsop. By March 2000 the number had grown to 137, and the company was hiring at the rate of 20 new employees per month. The PDA agreed to provide a second building to accommodate the company's rapid growth. A lease agreement, with a floating rent formula based on factors such as cost of construction and interest rate, was signed. Wood Holdings Inc., a development corporation, was retained by the PDA to construct the new building. Wood Holdings leased ground from the PDA on which to construct the building, and entered into a Net Lease Agreement with the PDA, which allowed for the PDA's subsequent purchase of the building once completed. Wood Holdings obtained the construction loan from the Bank of Grays Harbor and the PDA was asked to guarantee the loan. At the time, the PDA was in the process of applying for permanent financing for the building from the HUD 108 program, which would be used to finance the building. When the building was complete, the PDA exercised its right to purchase the building from Wood Holdings, assumed the construction loan, and paid it off when the HUD 108 loan closed in August 2001. During the period of November 2000 through August 2001, SafeHarbor paid estimated rent of \$60,000 per month plus expenses, with acknowledgement that actual rent due would be adjusted when the HUD loan closed and SafeHarbor would be responsible for any difference between estimated rent paid and actual rent due. The difference was set at \$164,000 upon signing of the final lease. SafeHarbor paid \$50,000 of that deferred rent immediately upon signing and the balance was paid by January 2002. Final rent was set at \$1.59/sf/mo. or \$68,800/mo. for 2001, escalating at 3% per year for the 20-year lease.

SafeHarbor moved into the new building in November 2000. The HUD 108 loan was approved in December 2000. By spring 2001, SafeHarbor's employment was approaching 300 people, but at the end of the first quarter 2001 the company was forced to make a reduction in its work force. The decision was made shortly thereafter to consolidate employees into the original building to save on costs, until such time as space was needed again in the new building. However,

SafeHarbor has paid and continues to pay full rent and operating expenses for the building. Recently, a new technology company agreed to lease the entire building from the PDA for 10 years with two five-year renewal options. In the new agreements, SafeHarbor remains responsible for the building lease in the event that the new company does not stay for the balance of the term.

The revised FF&E agreement, signed in January 2002, shortens the repayment term by seven months and calls for a balloon payment of \$1.496 million in June of 2003, with the company making monthly interest payments, which are tied to the cost of money and thus change each month.

Boise-Cascade Corporation

In October 2000, the Authority signed an agreement with Boise Cascade, a wood products business. Boise will build a \$70 million production plant using four existing warehouses as the foundation. The lease is for 30 years with a 10-year renewal option. The terms of the lease enable the company to defer lease payments for the first five years. The PDA used a net present value of approximately \$2.3 million and a return on investment of 15 percent to calculate lease payments, which include interest on the deferred rent. Payments begin in 2005 and triple by year 2012. The sale of water utility services is worth an additional \$150,000/year, escalated at 3 percent/year for the term of the lease.

Duke Energy Grays Harbor

The North Carolina energy company purchased 20 acres on the Satsop site from Energy Northwest (formerly WPPSS) to construct a \$300 million electricity-generating facility. The company broke ground on the site in September of 2001 and is expected to be on-line by June of 2003. The Authority signed a letter of intent for a water systems lease agreement that gives Duke the right to purchase up to 9.5 cfs of industrial water from the PDA, either during low flow conditions (\$300,000/year) or on a full-time basis (\$1.1 million/year). The PDA has water rights to 20 cfs of industrial water. Additionally, Duke will invest \$2-plus million in system improvements and pay the PDA \$212,000 up front for lease of the system, plus annual lease payments. Duke will also operate and maintain the system for the benefit of the Park.

The Authority's Financial Position

For 2000, the Authority posted a \$3 million net operating loss. Authority officials state this was due to the need to update infrastructure and the push for rapid expansion and growth during the start up phase.

In May 2001, the Authority began layoffs in an effort to cut costs. The Authority closed fiscal year 2001 with \$2.67 million in unrestricted cash and investments and had spent \$10 million for operations and \$13 million on property, plant and equipment and various construction projects. It is owed approximately \$2.1 million in accounts and leases receivable.

The Authority currently has 18 full-time employees and operates on an annual budget of about \$3.1 million.

PDA Response – Financial Position

The PDA ended 2000 with approximately 32 employees. It ended 2001 with 17.6 employees. Layoffs were begun in Spring 2001 and continued through December. As a point of clarification, the figures recited above, of \$10 million for operations and \$13 million for property plant and equipment, are cumulative capital investment figures for the years 1999 and 2000, and are not 2001 budget figures or 2001 expenditures. The Authority ended 2001 with income from operations, before depreciation and amortization expenses, of \$265,000.

At the end of the first quarter of 2002, the PDA had approximately \$3 million in unrestricted cash and investments (in effect, one year's worth of operating capital in the bank), and income from operations, before depreciation and amortization expenses, of \$251,000.

Role of the Authority's Board

The Board has seven Members. The Grays Harbor County Commission, the Grays Harbor Public Utility District (PUD) and the Port of Grays Harbor each appoint one of their current members. Those three Members appoint the remaining four Members who are to be civic or business leaders with expertise in finance, real estate development, law and/or construction projects. All members must be residents of Grays Harbor County. The County Commissioners have final approval over all appointments made to the Authority's Board.

The Authority's Charter states that the Board is responsible for managing "all Authority affairs." Board Members are responsible for reviewing and approving all Authority expenditures and for appointing employees to oversee the Authority's day-to-day operations.

The Board is ultimately responsible for ensuring the Authority carries out the programs it was created to do and for making sound financial decisions that are in the best interest of the public.

These Board Members served during the audit period:

Grays Harbor County Commissioner	Bob Beerbower
Grays Harbor Public Utility District	Frank Moses
Port of Grays Harbor	Jack Thompson
	William "Don" Wallace
	Diane Ellison
	Jack Durney
	Mike Miller (resigned April 24, 2001)

(Note: Frank Moses replaced Tom Casey as the Public Utility District representative in September 2000. Ron Rogstad filled the position vacated by Mike Miller in August 2001.)

With the exception of Commissioner Beerbower, Board Members received compensation of \$500 per month for regular Board meetings, with an additional payment of \$70 for other Authority-related meetings they attend. During the period we audited, they each received an average of \$6,840 per year for Board meetings.

Role of the Authority's administrators

Board members appoint the Authority's administrators. These Administrators served during the audit period:

Chief Executive Officer/President	Steve Romjue
Director of Finance	Pam Richards

(Note: Tami Garrow took over as Chief Executive Officer in May 2001. The Director of Finance position was eliminated May 1, 2001.)

The Administrative officers are responsible for the day-to-day operations of the Authority. They are to establish and maintain an effective internal control system to ensure the Authority meets appropriate goals and objectives, safeguards public assets, follows laws and regulations and maintains and reports reliable financial information. The Authority's administrators also must make a full accounting of business activities to the public and to the Board.

Audit Areas Examined

Grays Harbor Public Development Authority Grays Harbor County January 1, 1999 through December 31, 2000

In keeping with general auditing practices, we do not examine every portion of the Grays Harbor Public Development Authority's financial activities during each audit. The areas examined were those representing the highest risk of noncompliance, misappropriation or misuse. Other areas are audited on a rotating basis over the course of several years. The following areas of the Authority were examined during this audit period:

LEGAL COMPLIANCE

We audited the following areas for compliance with certain applicable state and local laws and regulations:

- Legal and supported expenditures
- Compliance with state bid laws
- Lending of credit
- Legal and supported investments
- Legal and supported contracts
- Conflict of interest
- Legal and supported payroll expenditures
- Open Public Meetings Act/minutes

INTERNAL CONTROL

We evaluated the following areas of the Authority's internal control structure:

- Cash receipts
- Billings and account receivable
- Accountability over public dollars
- Fixed assets including those that are small and susceptible to theft

FINANCIAL AREAS

Our opinion on the Authority's financial statements is provided in a separate report, which includes the Authority's financial statements and other required financial information. The financial activity and balances were examined, which included a review of:

- Cash and investments
- Revenues
- Expenditures
- Long-term debt
- Overall presentation of the financial statements

FEDERAL PROGRAMS

We evaluated internal controls and tested compliance with federal requirements, as applicable, for the Authority's major federal programs, which are listed in the Federal Summary section of the financial statement and federal single audit report.

Schedule of Audit Findings

Grays Harbor Public Development Authority Grays Harbor County January 1, 1999 through December 31, 2000

- 1. The Authority entered into an arrangement with a private company to finance the company's development of computer software and related products. The Authority paid \$1,084,961 to the company and has no documentation showing any goods or services were received.**

Background

In 1999, Cypress Resources, LLC, contacted the Authority with a proposal that the two entities enter into a joint venture to provide "e-services."

The Authority's attorney reviewed the contract. In a letter to the Authority's former Chief Executive Officer, which was never shared with the Board, the attorney raised significant concerns about the contract's lack of specifics regarding deliverables and ownership of them, and stated that the Authority would incur severe penalties if it terminated the contract.

In May 2000, the Authority Board approved the \$1.6 million contract between the Authority and Cypress. In April 2001, the Authority cancelled the contract after paying \$859,961 and receiving no revenue, services or products from the company. As a result of the contract cancellation, Cypress and the PDA entered into mandatory arbitration. The Authority agreed to pay an additional \$225,000 to cancel the contract rather than continue the litigation process.

The contract stated that any products developed during the project would be owned by Cypress, but that the Authority would be given a license to use them. The contract vaguely described e-services as activities associated with the development and implementation of electronic commerce services, but provided no specific information on what those services might be. The deliverables as described in the contract were related to computer software; business and marketing plans; and communications and public relations plans. However we found no documentation that showed the Authority received any of these from Cypress.

The contract described a profit-sharing arrangement between Cypress and the Authority through which the Authority was to receive 75 percent of the first \$1 million generated from this venture and 50 percent of what was generated thereafter. The compensation schedule of the contract stated that during the first year of the agreement, the Authority was to pay Cypress \$62,500 per month for management consulting fees and an additional \$10,000 per month for expenses. However, in the body of the contract, it clearly states that Cypress is solely responsible for all expenses incurred.

Description of Condition

Before the contract was cancelled, the Authority paid \$859,961 to Cypress Resources and received no benefit in return. We found that even though the Authority administrators and the Board had questions about what they were responsible for paying for and what they were receiving, all invoices were paid.

For example:

Prior to the official contract being signed, the Authority paid \$75,000 to Cypress Resources in two installments.

- The first of the two payments was based on an invoice that referenced a “task order” and requested \$50,000 for “January Development Fee.” The former Chief Executive Officer signed a “task order” with Cypress Resources on January 4, 2000. This document appears to be a precursor to the \$1.6 million contract signed in May 2000 since it has much of the same language. No specific evidence was available for review that could substantiate that Cypress performed any work for the Authority in January 2000.
- The second payment was based on an invoice that requested \$25,000 for web site development. Cypress Resources began development of the web site, but was unable to complete the project to the satisfaction of PDA management. The Authority had to pay another contractor \$7,140 to develop the web site.

The \$1.6 million contract required each invoice from Cypress Resources to specifically describe the services provided. However, the invoices described the work performed as “fees”, “management fees” and “management consulting fees.” Other than the invoices, we found no evidence that any services were provided. In fact, it does not appear that the Authority knew exactly what it was paying for as evidenced below:

- On the first invoice billed under the contract in May 2000, Cypress Resources requested \$217,500 for consulting fees for the months of March, April and May. The Authority paid \$100,000 and indicated on the invoice that the payment was for May and June. This indicates that there was confusion as to the terms of the agreement, what months services had been performed and that the Authority was pre-paying for June consulting services. State law prohibits paying for services before they are rendered.
- The June 2000 invoice requested \$45,000 and referred to this amount as the remaining balance for May and June. Therefore, \$27,500 of the amount paid in May represents a prepayment for services. State law prohibits paying for services before they are rendered.
- The July and August invoices were for \$72,500 each. The invoices indicate that \$10,000 for each of the two months was to reimburse expenses. At the time the payment was approved, the Authority wrote on the invoice that it needed documentation to back up the request. Cypress did not provide the documentation, but the claims were paid anyway.
- The September billing was for \$62,500 but included the following explanation from Cypress: “Only \$62,500 of the \$72,500 amount is billed for this month. The balance - \$10,000 will be billed on the next invoice and called “expenses” for the month of September 2000, even though per contract Cypress is solely responsible for its expenses. This breakout of expenses for this month is at the request of the Grays Harbor Public Development Authority.” Cypress admits here, that it is responsible for expenses, but billed the Authority for them anyway.
- The October billing illustrates again that the parties are confused about the payment structure. Along with the \$62,500 monthly billing for unsubstantiated services Cypress included \$7,325 for September “expenses.” Cypress included this explanation: “Fees per contract billed less \$10,000 for expense budget. Balance of any expenses billed that are less than the \$10,000 amount will be billed at a later time when and if actual expenses occur and have not exceeded the \$120,000 annual budget.” Obviously, the \$10,000 expenses referred to in the prior invoice was not based on actual expenses. As with all payments for expenses, no supporting documentation to substantiate the claim was ever provided.

- The remaining invoices for November through March 2001 were all billed at \$62,500 per month plus expenses. Expenses varied from \$5,255 up to \$13,483. In total the Authority paid Cypress Resources \$97,461 for expenses without any supporting documentation or a clear understanding of whether or not expenses were allowed under the contract.

Cause of Condition

The terms of the contract were conflicting and vague. The Authority Board did not exercise appropriate oversight of the contract, relying solely on information provided by the former Chief Executive Officer. The Board approved payments on the invoice, without requiring the appropriate, specific documentation needed to ensure the payments were appropriate and for services actually received.

Effect of Condition

Once the Board voted to terminate the contract, the Authority entered into arbitration. As a result, the Authority paid an additional \$225,000 to end the contract rather than continue with litigation. The Board determined the settlement amount was better than continuing with the contract at a cost of approximately \$982,500. We were unable to determine what the Authority received in exchange for its total of \$1,084,961 in payments to Cypress Resources.

Authority's Response

The PDA Administrators during 1999 and 2000 left the PDA in May 2001. All Finance Department positions were eliminated in 2001. Current staff is unable to address the issues raised in the Description of Condition referring to billing questions such as pre-payment, what was owed vs. what was paid, billing structure, etc.

There appears to be ambiguity in the Cypress contract with regard to the level of detail required for expenses as set forth in various parts of the contract. As the contract progressed, the PDA did attempt to obtain additional expense documentation from Cypress.

On May 21 2001, the current CEO met with the Audit Manager of the State Auditor's office to request an immediate audit of the PDA for 1999 and 2000. The Cypress contract was of high concern because the PDA had just taken action to terminate it and was eager to resolve the issue. That action triggered the arbitration process spelled out in the contract. Upon meeting with the Washington Arbitration and Mediation Service (WAMS) arbitrator in July 2001, the PDA was asked to contact the State Auditor's Office and request an expedited review of this particular contract, as it was known to be one of the principal areas of focus in the 1999 and 2000 audit of the PDA, which was currently underway. The arbitrator was interested in the State's opinion of this contract, as it could have bearing on the arbitration process. State audit staff indicated that the audit was expected to be completed within 60 days, and the arbitrator agreed to postpone arbitration until October 2001. However, in October it did not appear that the audit report was nearing completion and the arbitration process was required to move forward, with document discovery and depositions beginning in November. In December 2001, the PDA reached a settlement with Cypress for \$225,000. The PDA felt it prudent to settle versus risk the cost of the arbitration process and the further risk of an unknown outcome. The PDA's exposure was an approximate additional \$1 million had it not cancelled the contract and settled the dispute.

In November 2001, as part of the discovery process prior to settling the Cypress contract, the PDA was able to obtain a CD-Rom containing various work products and information produced by Cypress Resources under the terms of the PDA contract. This included copies of the E-Commerce business plan, e-services marketing plan, risk mitigation plan, activity reports, which were presented to the Board at periodic intervals, contact lists, customer lists, calendars, proposals submitted to potential customers, and other work products. Copies of these

documents were made available to the State audit staff on a return visit to the PDA in February 2002 prior to completion of this report.

PDA staff had the understanding that the former CEO worked with the Auditor's office and with the PDA's former attorneys to address issues surrounding this contract both before the contract was signed and after it was in place. The former CEO notified the Board on April 1, 2000, that a copy of the contract was being sent to the Auditor's office for review; a May 5th update sent to the Board states "The e-services contract has been reviewed by the State Auditor's office. I discussed the contract with them and have made relatively minor changes to address their questions and concerns. The contract is now in final form and is ready for board approval." The PDA Board approved the contract later that month. The Board provided policy direction to the CEO; the CEO carried out those directives, reporting back to the Board as necessary. To the best of our knowledge, the Board had no interaction with or contact from the State Auditor's office prior to this Audit.

Beginning in 2001, the PDA Board has a formally appointed Executive Committee (which consists of Jack Thompson, Chair; Diane Ellison, Vice Chair; and Jack Durney) and Finance Committee (which is comprised of Dr. Don Wallace, Frank Moses and Ron Rogstad), which meet on a regular basis. The Executive Committee meets twice a month with the CEO, to review current PDA activities and provide improved oversight of the organization. The Finance Committee meets monthly with the CEO to review financial statements, budget reports, bills and investment reports, to examine current PDA financial activities and provide improved oversight. The PDA's attorney attends all PDA Board meetings, Executive Sessions, and most Executive Committee meetings to provide advice and counsel. A professional financial consultant was retained (on an hourly basis) to oversee the PDA's financial activities and provide advice and direction. These steps have been taken to increase accountability at the highest levels of the organization and provide a greater level of information exchange between staff and Board. PDA staff also regularly confers with state audit staff for clarification, advice and direction on issues that may have a material effect on the PDA.

Auditor's Remarks

We thank the Authority for its response to our finding. We appreciate the steps taken by the Board to establish and follow new policies and procedures to ensure compliance in the future.

Applicable Laws and Regulations

RCW 42.24.080 prohibits claims from being paid before services are rendered.

All claims presented against any county, city, district or other municipal corporation or political subdivision by persons furnishing materials, rendering services or performing labor, or for any other contractual purpose, shall be audited, before payment, by an auditing officer... The form shall provide for the authentication and certification by such auditing officer that the materials have been furnished, the services rendered or the labor performed as described, and that the claim is a just, due and unpaid obligation against the municipal corporation or political subdivision

The terms of the contract state:

Article D; section 2.2.

CRLLC (Cypress) shall submit a billing statement ("Invoice") to GHPDA (Authority), by the 10th day of each month, which details the amount and composition of the billing.

Article D section 2.4.

CRLLC shall be solely responsible for all expenses incurred by it in performance of its obligations hereunder

Referring to deliverables, contract states in part in Article D section 3.3:

Any proprietary or secret concepts, methods, techniques, processes, adaptations or ideas discovered or developed by CRLLC in its performance hereunder shall be its sole intellectual property . . . GHPDA shall have a non-exclusive license for any such patents, copyrights or intellectual property

Schedule of Audit Findings

Grays Harbor Public Development Authority Grays Harbor County January 1, 1999 through December 31, 2000

2. The Authority did not comply with state bid laws and had poor internal controls over contracts.

Background

During the period audited, the Authority began work on several major projects. We selected two for review based on their size and the amount spent.

The first project, known as SafeHarbor Building No. 1, was a \$4.7 million remodeling effort. The other project was construction of SafeHarbor Building No. 2 at a cost of \$6.3 million.

Description of Condition

SafeHarbor Building No. 1

The agreement signed by Energy Northwest and the Authority, transferred ownership of all buildings at the business park to the Authority. The original project was started by the Satsop Revitalization Project, prior to the inception of the PDA. The Authority subsequently leased the administration building to SafeHarbor. As part of the lease, the Authority agreed to remodel the building and to pay for tenant improvements. The scope of the project changed several times prior to completion. We found the Authority did not adequately manage change orders during projects, resulting in costs far exceeding original estimates.

For example, tenant improvements initially set at \$20 per square foot rose to \$60 per square foot. The total amount of tenant improvements was \$2,869,980. The lease includes an option to call for payment of \$1 million after two years; the Authority exercised this option in March of 2002. The tenant will pay the remaining balance over the life of the lease.

We found no documentation showing that any of the project was competitively bid.

SafeHarbor Building No. 2

Based upon our review of documents and interviews, we believe the Authority entered into a complex financing arrangement to avoid the state bid laws.

In 2000, the Authority contracted with a private holding company to build SafeHarbor Building No. 2. Under the agreement, the Authority was to lease the building from the private company, with an option to purchase it. The Authority then planned to sublease the building to SafeHarbor. The Authority paid \$200,000 in engineering and architectural fees for the building as well as \$1.6 million in rent before construction was started. The bank financing the construction notified the Authority that it needed a guarantee before it would loan money to the private company. The Authority guaranteed the \$3.8 million loan (See Finding 3 on lending of credit). Once the building was substantially complete, the Authority exercised its purchase option. The total cost of the building was \$6.3 million.

Cause of Condition

During the audit, Authority personnel stated that SafeHarbor placed significant pressure on the Authority to complete the projects. They stated that due to those time pressures, they could not take the time to properly bid the projects.

Effect of Condition

The state's competitive bid laws are designed to ensure that public contracts are performed satisfactorily and efficiently at the least cost to the public, while avoiding fraud and favoritism.

By circumventing these laws, the Authority cannot ensure it received the lowest price or that all vendors were provided an equal opportunity to submit a quote on the public projects.

In addition, by using this method to construct the building, the Authority incurred additional expenditures totaling approximately \$225,000. This was made up of \$180,000 paid to the holding company as a development fee and \$45,000 paid to the title company for the transfer/sale. These costs would not have been incurred had the Authority bid the project and paid the contractor through the normal disbursement process.

Recommendations

We recommended the Authority comply with state law regarding when it must put projects up for bid. Competitive bid laws are designed to ensure projects funded by public dollars are awarded to the lowest, most responsible bidder.

Authority's Response

Building No. 1: *Building No. 1 is a 47,833 sq. ft. temporary building that was used as the Construction Office Building by WPPSS. The building was not intended as a permanent structure but was to have been torn down upon completion of the nuclear plant. However, the building remained and in November of 1998 SafeHarbor rented a 5,000 sq. ft. corner of the building to begin operations at the soon-to-be-formed Satsop Development Park. SafeHarbor was a tenant of the Satsop Redevelopment Project (the SRP) which was an interlocal organization formed by the Port of Grays Harbor, Grays Harbor County and the PUD. The SRP was the predecessor to the PDA.*

Renovation of this building was undertaken by the SRP. The SRP divided up the work to be done at the Satsop site, with the Port of Grays Harbor undertaking initial marketing efforts; the County developing the PDA itself; and the PUD doing whatever construction-type work was required. The work done by the SRP entities was reimbursed utilizing the BPA funds. Thus, the renovation of the Construction Office Building was started by the PUD through their membership in the Conservation and Renewable Energy System (CARES) Program. CARES is a joint operating agency in the State of Washington consisting of multiple PUDs, and at the time the Grays Harbor PUD was one of those utilities participating in the program. Steve Romjue, former CEO of the GHPDA, was the General Manager of the Grays Harbor PUD at the time the project was started by the PUD. It was the PDA's understanding that the Construction Office Building (now known as Building 1) renovation project begun by the PUD followed the rules specified by the State of Washington's Performance Contracting laws and procedures. It was also the PDA's understanding that a similar process was used by CARES and other public entities for similar facilities renovation projects.

Because SafeHarbor was occupying a portion of the bottom floor of the building, the renovation of the building was started on the top (the second) floor. This work included a substantial amount of improvements such as new HVAC systems, wiring, plumbing, roofing, windows, etc.

Responsibility for overseeing the renovation project eventually transferred to the PDA in 1999, when the PDA had staff and offices on site.

When the upstairs renovation was essentially complete, the decision was then made by the PDA to grant the tenant an improvement allowance and have SafeHarbor itself undertake renovation of the bottom floor of the building, since the majority of the improvements for which the landlord was responsible, had already been done as part of the top floor renovation. Most of the work remaining to be done on the bottom floor would be classified as tenant improvements and would be done by the tenant using whatever contractors and procedures the tenant deemed acceptable. The PDA retained the right to review and approve the improvements, as is common in most lease agreements. SafeHarbor selected Quigg Bros. Construction of Aberdeen as their primary contractor.

The initial tenant improvement allowance was set at \$20/sq. ft., with no clear understanding at the time of the extent to which the building would need to be remodeled to meet the tenant's needs which included sophisticated telecommunications infrastructure that would be unique to the tenant and thus be their responsibility, not the landlord's. That allowance was increased to \$60 per sq. ft. during construction, and that rate was locked into the revised lease agreement with the PDA, which was signed when construction was complete. Currently, \$36,000 per month, or approximately half of SafeHarbor's monthly rent, goes towards repayment of tenant improvements. That cost escalates by 3 percent per year for the life of the lease.

Because the tenant improvement allowance had increased, the PDA included a provision in the revised lease that allowed it to request early repayment of \$1 million worth of tenant improvements. The PDA made that request in March of this year as allowed under the terms of the lease.

Improvements that were made in excess of the tenant improvement allowance were paid for by SafeHarbor.

Because SafeHarbor rather than the PDA did this bottom-floor renovation, it appears that the PDA did not believe that SafeHarbor was required to go through the public bid process for their improvements. The downstairs remodel included classrooms, meeting rooms, offices, a cafeteria and exercise room, and these were considered to be tenant improvements. All tenant improvements become property of the PDA at the end of the lease, unless the tenant removes them.

Furthermore, because the major building renovation (HVAC, wiring, plumbing, windows, etc.) was begun through the PUD, completed by PDA staff, and then SafeHarbor stepped in and did the balance of the remodel themselves, it is difficult to separate the work and thus establish when and whether bid procedures should have been used, and by whom, vs. the mechanisms used by the PUD program and the procedures that SafeHarbor used. It appears that PDA staff believed that completing the project in the manner in which it was started, was appropriate for the renovation.

Today the PDA has procurement procedures in place and seeks to follow public bid laws and laws governing small works rosters. It is the PDA's intent that all future renovation or construction projects be handled according to state law, to the best of our knowledge and abilities.

Building No. 2: *In 2000 the Authority contracted with Century Pacific Group, a development company, through their subsidiary of Wood Holdings, to build a new building on site, which the PDA intended to purchase, and then lease to SafeHarbor. Wood Holdings and the Bank of Grays Harbor requested that the PDA be the guarantor of the construction loan from the Bank of Grays Harbor. Since the PDA's intent was to purchase the building when complete, the PDA did guarantee the loan and believed it had the power to do so through its charter and state statute. Correspondence from the GHPDA's legal counsel at the time indicates that this project was reviewed by PDA legal counsel for compliance with state bid law as well as other issues, prior to*

commencement of this project. The construction loan was for \$4.5 million, and as soon as the building was completed the loan was rolled over into the PDA's name. When the HUD loan was finally closed, the Bank of Grays Harbor construction loan was paid off. The final cost of the building was approximately \$6.3 million. Wood Holdings solicited bids from three companies (two of them local) and selected Rognlin's Construction of Aberdeen to build the new building.

With regard to the development fee paid to Wood Holdings, the PDA would like to note that had it built the building itself, additional costs would have still been incurred by the PDA since it had no staff whose expertise was in office building construction, project oversight or similar tasks. It was a brand new organization, and was not in the construction business. Thus the PDA believes that development costs would have been unavoidable in that it would have cost the PDA significant funds to do this regardless of whether it was done in house or contracted out or included as part of a more comprehensive construction package.

Auditor's Remarks

We appreciate that the Authority concurs with our audit recommendations. We will follow up on this issue during our next audit.

Applicable Laws and Regulations

RCW 35.21.759 spells out the applicability of general laws to public development authorities.

A public corporation, commission, or authority created under this chapter, and officers and multimember governing body thereof, are subject to general laws regulating local governments, multimember governing bodies, and local governmental officials

RCW 39.04.010 defines a public works as:

The term public work shall include all work, construction, alteration, repair, or improvement other than ordinary maintenance, executed at the cost of the state or any municipality

RCW 36.32.240 states in part:

In each county with a population of less than one million . . . shall contract on a competitive basis for all public works, enter into leases of personal property on a competitive basis, and purchase all supplies, materials and equipment, on a competitive basis

RCW 36.32.245 states in part:

No contract for the purchase of materials, equipment, or supplies exceeding \$25,000 may be entered into by the county legislative authority or by any elected or appointed officer of the county until bids have been submitted to the county. Before awarding any such contract

Schedule of Audit Findings

Grays Harbor Public Development Authority Grays Harbor County January 1, 1999 through December 31, 2000

3. The Authority loaned its credit to private companies.

Description of Condition

We reviewed the Authority's contracts and identified two instances in which the Authority loaned its credit to private organizations.

- a. The Authority inherited an agreement with SafeHarbor, Inc., a private company, that was originally negotiated by the Satsop Redevelopment Project (SRP) in January of 1999. The original agreement was for \$2 million that could be paid down and re-borrowed up to the maximum amount and carried a repayment term of five years. This agreement would enable the company to purchase furniture, fixtures and equipment. Although the PDA Board capped the amount at \$2,264,819 in July of 2000, the **original** agreement resulted in the Authority loaning its credit to a private company. The agreement stated the money would be repaid in increments of \$72,284 monthly plus interest for three years. Under the agreement, once the lease is paid off, SafeHarbor will own the equipment. At the end of 2001, SafeHarbor still owed the Authority \$1,578,279. An agreement signed with the Authority in January 2002 sets new conditions for the repayment of the loan. Under that agreement, SafeHarbor will pay only interest (\$5,700 a month) through June 2003 when the company must pay the balance.
- b. In April of 2000, the Authority inappropriately guaranteed a \$3.8 million construction loan for a private company. This guarantee obligated the Authority to take over the debt in the event the private company defaulted on the loan. The Authority assumed the loan when it exercised its option to purchase the completed building. That loan was repaid with money from a subsequent long-term mortgage the Authority obtained from the U.S. Department of Housing and Urban Development. The Authority is making timely payments on that loan.

Cause of Condition

Management viewed these transactions as benefiting the Authority and considered them allowable under the terms of the Authority's Charter. The Board approved these transactions.

Effect of Condition

The Authority loaned its credit to two private businesses, placing public resources at risk and violating the state Constitution.

Recommendations

The Authority should comply with the state constitutional ban on the loaning of credit to private organizations. The Authority should examine its charter and take the steps necessary to ensure that the charter is in compliance with state laws regarding public development authorities. We also recommend that the Authority Board and financial officers ensure they are familiar with state law in this area.

Authority's Response

SUMMARY:

The Grays Harbor Public Development Authority was operating under the belief that it was acting within its authority according to the organization's charter as well as State statutes. Greg Forge, an attorney retained by the SRP to work with Stuart Meneffee, the Grays Harbor County prosecutor, to develop the organization's charter and bylaws, developed the PDA's charter. The Charter was carefully reviewed for compliance with state statute, and was adopted by the Grays Harbor County Commissioners in public meetings held in 1998.

PDA legal counsel respectfully disagrees with the conclusion that the actions of the GHPDA were in fact a violation of Article VIII, Section 7 of the Washington State Constitution and submits that neither the charter, the statutes relating to Public Corporations, nor the case law of Washington supports the conclusion reached by the Auditor's office. The PDA would very much appreciate a careful review of the facts recited below as well as a final legal determination on this vitally important issue as it affects not only the Grays Harbor Public Development Authority but perhaps other PDAs and similar public corporations as well.

FACTS:

The Audit Report properly notes that the agreement for the purchase of Fixtures, Furniture and Equipment (FF&E) with SafeHarbor was inherited by the GHPDA. That agreement was entered into before the GHPDA had any staff or funds. The agreement was eventually transferred to the GHPDA.

The Audit Report notes that the GHPDA "inappropriately guaranteed" a loan for the construction of an office building located on GHPDA property. A review of the resolution authorizing the construction, lease and acquisition of SafeHarbor Building No. 2 (Resolution No. 2000-07) confirms the intent of that transaction. It also confirms the GHPDA understanding of the powers it had been given under its Charter. The recitals of that resolution are set forth below:

- *WHEREAS, Article IV of Ordinance 246 (GHPDA charter) identified GHPDA purposes; and*
- *WHEREAS, among the county imposed purposes is the creation of an independent legal entity to undertake, assist with and otherwise facilitate the redevelopment of the Satsop power site including, but not limited to, the development, construction and maintenance of structures and facilities; and*
- *WHEREAS, Article IV of Ordinance 246, in order to implement these purposes, **authorizes the GHPDA to secure financing and enter into agreements with private entities or private developers to develop commercial or industrial projects on the Satsop property; and***
- *WHEREAS, Article IV of Ordinance 246 directs that the GHPDA shall work to **maximize private sector participation** in such projects; and*
- *WHEREAS, Article IV of Ordinance 246 finds the above described functions, goals and purposes to be an **essential governmental function and a public purpose**; and*
- *WHEREAS, Article V of Ordinance 245 identifies GHPDA powers including, but not limited to, the authority to; lease property; contact with individuals or corporations for any authority purpose; **lend money; lend funds, property or credit for authority purposes and act as a surety or guarantor for authority purposes**; and provide money, property or services on such terms as the authority in its discretion deems advisable to individuals, associations or corporations for authority purposes; and*

- *WHEREAS, Safe Harbor Technology Corporation (Safe Harbor) is viewed as a critical tenant for achieving the purposes imposed on the GHPDA by county ordinance, and that the preservation of Safe Harbor as a tenant and employer in Grays Harbor County is viewed as critical to the success of the GHPDA and county economic development; and*
- *WHEREAS, Safe Harbor's growth is reasonably anticipated to exceed GHPDA office space capability in the second or third quarter of calendar year 2000; and*
- *WHEREAS, in order to preserve Safe Harbor as a GHPDA tenant and Grays Harbor business, it is necessary to construct a new office building adjacent to its existing facility containing approximately 40,000 square feet; and*
- *WHEREAS, the deadlines for providing the additional space required to retain Safe Harbor as a tenant require expedited construction process and staff expertise which are best provided through a cooperative effort with private enterprises; and*
- *WHEREAS, GHPDA staff have identified a developer, architect and contractor from the private sector having the requisite training, skills and experience to design and construct what is commonly referred to as the Safe Harbor Building No. 2; and*
- *WHEREAS, in order to implement the procedures required to expeditiously construct the Safe Harbor Building No. 2, it is necessary for the GHPDA to enter into a series of leases;*

Thereafter, the Board of Directors authorized the agreement with the private developer that became one of the subjects of this audit finding. The GHPDA based its decision on its Charter and legal advice that its actions were appropriate.

LEGAL ANALYSIS:

Chapter 35.21 RCW:

Grays Harbor County formed the Grays Harbor Public Development Authority in 1998 pursuant to the authority given to counties under Chapter 35.21 RCW. Under RCW 35.21.730, counties have the power to create public corporations and grant them the following powers:

- *Administer and execute federal grants or programs;*
- *Receive and administer private funds, goods, or services for any lawful public purpose; and*
- *Perform any lawful public purpose or public function.*

RCW 35.21.745 provides as follows:

*Any public corporation, commission, or authority created as provided in RCW 35.21.730 may be empowered to own and sell real and personal property; to contract with individuals, associations, and corporations, and the state and the United States; to sue and be sued; to **loan** and borrow **funds** and issue bonds and other instruments evidencing indebtedness; transfer any funds, real or personal property, property interests, or services; to **do anything a natural person may do**; and to perform all manner and type of community services . . .*

In addition, the legislature also makes clear that public corporations do not have any power to "levy taxes or special assessments."

RCW 35.21.735 (5) expressly authorizes the loaning of funds to public or private parties and expressly finds that such loaning is a “lawful public purpose” of public corporations. That section of the statute reads as follows:

*For purposes of this section, “lawful public purpose” includes, without limitation, any use of funds, **including loans thereof to public or private parties**, authorized by the agreements with the United States or any department or agency thereof under which federal or private funds are obtained, or authorized under the federal laws and regulations pertinent to such agreements.*

Section 6 of that same statute also includes a description of the authority to loan or grant federal or private funds “to any private party”.

Charter of Grays Harbor Public Development Authority:

The Charter of the Grays Harbor Public Development Authority conformed to the powers given by the Washington State Legislature to public development corporations.

Article IV of the Charter states that the GHPDA’s purpose is the “redevelopment” of the Satsop Power Site “currently an underutilized and blighted area of the county.” The preamble also states that the redevelopment of the Satsop property by the Authority “serves essential public purposes by relieving blight; providing public access to and enjoyment of the Satsop property; undertaking development of an underutilized area in the county . . . facilitating private investment which will build the county tax base; providing for the development of reasonable amenities; cultural institutions; and recreational facilities; all of which will serve the public.”

The GHPDA was empowered to “acquire and manage real property; secure financing; undertake the development, construction and maintenance of structures and facilities . . . enter into agreements with cultural, public or private entities or with private developers proposing to develop public facilities or commercial, industrial or residential projects on the Satsop properties.” (Article IV)

In order to carry out these responsibilities under Article V of the charter, the GHPDA was authorized to do the following:

- **Lend and borrow money (Article V, Section 4)**
- Lend its funds, property, credit or services for Authority purposes, or act as a surety or guarantor for Authority purposes **(Article V, Section 8)**
- Provide money, property or services **on such terms and conditions as the Authority may, in its discretion, deem advisable** to individuals, associations or corporations for Authority purposes **(Article V, Section 10)**

Under the specific duties given to board members (Article VII, Section 6), the charter recites that a general or particular authorization or concurrence of the board by resolution is necessary for transactions involving:

- **An action by the Authority as a surety or guarantor (B)**

Source of the Funds and Property:

The Audit Findings describe the source of the funds that the GHPDA used in its redevelopment efforts as being received from the Bonneville Power Administration (BPA). The report recites the source of the funds as follows:

The Authority was organized to facilitate the redevelopment of the Satsop site. In a series of transactions in 1999, the Authority gained title to the land, roads and other site improvements from the Bonneville Power Administration (BPA), which took over management of the property from WPPSS after the system's bond default. By the end of 1999, the BPA had paid a total of \$15 million in seed money to the Authority to help it develop the property as a business park. The BPA paid the Authority an additional \$10.75 million in 2000 for site restoration. The site work has been completed.

The funds were provided for the purpose of "redeveloping and operating the Satsop site" (Site Transfer Agreement, Section III). Any property transferred was intended to be used for "the purposes of economic development in Grays Harbor County" (Site Transfer Agreement, Exhibit A, Section II). The real and personal property transferred consisted of the land and buildings, together with some equipment, located on the former Washington Nuclear Project Sites 3 and 5 near Satsop, Washington.

According to the website maintained by the BPA, it is a branch of the federal government. The BPA describes itself as follows:

While BPA is part of the Department of Energy, it is not tax-supported through government appropriations. Instead, BPA recovers all of its costs through sales of electricity and transmission and repays the U.S. Treasury in full with interest for any money it borrows.

Therefore, under RCW 35.21.735 (5), the GHPDA was carrying out the lawful loaning of funds received from the federal government. It is worth re-quoting that statute:

*(5) For purposes of this section, "lawful public purpose" includes, without limitation, any use of funds, including **loans thereof to public or private parties**, authorized by the agreements with the United States or any department or agency thereof under which federal or private funds are obtained, or authorized under the federal laws and regulations pertinent to such agreements.*

The funds that were used were funds that were designated for the re-development of the site.

The GHPDA respectfully disagrees with the opinion expressed by the Assistant Attorney General in a letter dated March 27, 2002, that the funds did not retain their federal character after receipt by the GHPDA.

RCW 35.21.757:

The State Auditor's Office has determined that RCW 35.21.757 limits the authority granted by the Washington State Legislature, as opposed to being a statement by the Washington State Legislature that the powers the State Legislature has given to public corporations do not violate the Washington State Constitution.

That 1985 statute reads as follows:

Nothing in RCW 35.21.730 through 35.21.755 shall be construed in any manner contrary to the provisions of Article VIII, Section 7, of the Washington State Constitution.

The GHPDA acknowledges the position of the Auditor's office and the legislative history cited by the Assistant Attorney General in a letter dated March 27, 2002.

However, given the source of the funds, i.e. the federal government, it is respectfully submitted that the authority granted by RCW 35.21.730 through

35.21.755 would permit the use of these federal funds for loans. The State Legislature gave Public Development Authorities the power to “**loan**” money and to “**do anything a natural person may do**” in the statutes that it enacted. It defined as a “**lawful public purpose**” the power to “use any funds, including **loans thereof to public or private parties**”.

The GHPDA respectfully disagrees with the opinion expressed by the Assistant Attorney General in a letter dated March 27, 2002, that the funds did not retain their federal character after receipt by the GHPDA. It was stated in the correspondence that this opinion does not represent an official opinion of the State Attorney General’s office.

Legislative History of RCW 35.21:

The GHPDA acknowledges the legislative history cited by the Assistant Attorney General in a letter dated March 27, 2002. However, the history of the legislation before the 1985 amendment that created RCW 35.21.757 warrants some consideration. The GHPDA acknowledges the testimony of Mr. Charles Goldmark and the House Bill Report on HB 956, the bill that included RCW 35.21.757. However, the history and enactments since that legislation support the position of the GHPDA that it was conforming to the statutes and not violating Article VIII, Section 7.

The memorandums from the legislative history maintained by the State Archives give a clear picture of the problem that this legislation was trying to solve:

1973:

- March 21, 1973 memorandum from James W. Guenther to Senator George Fleming, Chairman Local Government Committee, describes the issues presented by the legislation (then Senate Bill 2843):
 - a) In essence, Senate Bill 2843 would allow cities and towns to expend or make use of the option of federal funding without having to go to the state to have loans altered or changed . . .
 - b) The act does require that the governing body create such public corporations, thereby assuring that review of at least more than one person in the establishment of such public corporation. . .
 - c) The real crux of the problem is our constitution, and cities feel that unless they can shed the liability of the city that they may be in conflict with the state Constitution, which states that no government agency shall lend its credit.

Staff Report of May 18, 1973:

- a) The thrust of this legislation is the result of the new federalism at the federal level. What this legislation attempts to do is to state that cities may enter into contracts with the federal government and not be in conflict with state law, even though legislation may exist which would prohibit such action . . .
- b) Another crucial problem which exists is with the Constitution of the state of Washington. There are those individuals who would argue that the state cannot enter into contracts with the federal government for the purpose of constructing buildings or performing other types of services, since we would be violating the provisions of the constitution, which prohibits state government or its political subdivisions from lending its credit . . .

From those concerns came the bills that eventually became RCW 35.21.730. The memorandums issued in support of that legislation show that the legislature was creating a public corporation that would not violate the “lending of credit” prohibition:

- September 15, 1973, Office of Program Research memorandum contains the following descriptions of the sections of Second Substitute Senate Bill 2843 (eventually Engrossed Third Substitute Senate Bill):
 - a. Legislative intent is to provide cities and counties with the opportunity to participate in federal grant-in-aid programs.
 - b. Any city or county creating such a corporation shall oversee its operation. The corporation may own and sell property, contract with others, **loan** and borrow funds, but has no powers of eminent domain and no power to tax or levy assessments.
 - c. In the event of insolvency, the corporation’s liabilities shall be satisfied exclusively from its own assets, and the city or county is not liable.

1995:

In 1995 substantial revisions were made to the statutes that authorize public corporations. The memorandums supporting the amendments contain numerous references to the “lending of credit” issue, as follows:

- House Bill Report, SHB 1517, March 10, 1995:
 - a) The Washington State Constitution prohibits state and local government resources from being used for private purposes under the “lending of credit” provisions; **however, these restrictions do not apply to federal money.**
 - b) Virtually all the economic development lending and financing programs in Washington State are funded from federal resources where state and local government is acting as the pass through or “conduit” to private development.
 - c) Testimony for: Conduit financing is another tool available to local governments to encourage economic development. This tool is already available to Public Development Authorities. . . .
- Senate Bill Report, SHB 1517, March 16, 1995:
 - a) The State constitution expressly prohibits counties, cities, towns and other municipal corporations from giving or lending money, or extending credit, for the benefit of private individuals or entities . . . This prohibition restricts the ability of counties, cities, town and public corporations to participate in federal programs in which federal credit and funds are available to finance, or enable the financing, of economic development projects of benefit to the community. **Authority is desired to enable communities to take advantage of federal economic development programs, by establishing procedures that assure there is no violation of the constitutional prohibition on the lending of credit.**
 - b) Under “Summary of Bill” the report listed the following authorities granted to public corporations:
 - Enter into agreements with the federal government under which they may cause to be received and expended by the custodian or trustee, **federal** or private funds **for any lawful purpose;**

Finally, Section 2, (5) of SHB 1517 enacted in 1995, contained the amendments to the law that defined “**lawful public purpose**” to include “**use of any funds, including loans thereof to public or private parties**, authorized by the agreement with the United States or any agency thereof”

Again, although there is a disagreement with the Assistant Attorney General as to the character of the funds after receipt, the Auditor’s report confirms that the funds used were from the federal government. The Site Transfer Agreement states that the funds were to be used for the purpose of “redeveloping and operating the Satsop site.” The construction of an office building was part of the “redevelopment” of the site and the funds used on the FF&E were part of “economic development in Grays Harbor County”.

Conclusion:

It is respectfully submitted that the Grays Harbor Public Development Authority did not knowingly or willingly violate Article VIII, Section 7 of the Washington State Constitution in the manner in which it constructed an office building or in the furniture, fixtures and equipment agreement with SafeHarbor.

Auditor’s Remarks

We appreciate the concerns the Authority raised in its response. We look forward to working with the PDA to resolve the issue regarding the nature of the funds.

Applicable Laws and Regulations

Article VIII, Section 7 – Credit not to be loaned states:

No county, city, town or other municipal corporation shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company or corporation, except for the necessary support of the poor and infirm, or become directly or indirectly the owner of any stock in or bonds of any association, company or corporation.

RCW 35.21.757 Public corporations – Statutes to be construed consistent with state Constitution.

Nothing in RCW 35.21.730 through 35.21.755 shall be construed in any manner contrary to the provisions of Article VIII, Section 7, of the Washington State Constitution.

Schedule of Audit Findings

Grays Harbor Public Development Authority Grays Harbor County January 1, 1999 through December 31, 2000

4. The Authority improperly invested public funds.

Background

The Authority uses a private investment broker to manage its portfolio, however, Authority management makes investment decisions. The Office of the State Treasurer and the State Investment Board have established a list of eligible investments under the applicable state law.

Description of Condition

During our review, we noted the following investments in the Authority's portfolio that did not comply with state law:

	1999	2000
Certificates of Deposit with Out of State Banks (Total of 32 in 1999 and 54 in 2000)	\$ 2,956,218	\$ 5,131,400
Commercial Paper (250 Day Maturity)	1,213,470	-
Total Unauthorized Investments	<u>\$ 4,169,688</u>	<u>\$ 5,131,400</u>
Total Value of Portfolio	9,621,580	11,862,086
Total Percentage Unauthorized	<u>43.34%</u>	<u>43.26%</u>

Prior to June, the Director of Finance made investment decisions. However, currently the Chief Executive Officer and the Finance Committee make the decisions on investments and instruct the broker to make the transaction. The Finance Committee is made up of the Chief Executive Officer and three Board members. The Committee meets prior to the monthly Board meetings to review investment balances and the Authority's overall financial position. The Board reviews and takes action to formally approve monthly investment reports.

Cause of Condition

The Authority did not follow its formal, written policy to guide investments and it was unaware of requirements set out in state law.

Effect of Condition

By investing in out-of-state banks and in commercial paper (i.e. bonds) exceeding 180 days, the Authority violated state law.

Recommendations

We recommend the Authority comply with its investment policy and comply with state laws governing the investment of public funds.

Authority's Response

As noted earlier, the CEO and the Finance Committee meet monthly to review the organization's monthly financial statements, budget reports, bills, and investment activities. The CEO and Finance Committee make the decisions on investments, and instruct the broker to make the transactions. Those decisions are confirmed by the Board of Directors at monthly board meetings through the formal adoption of financial statements and investment reports, as well as formal approval of bills for payment.

The GHPDA's investment policy and applicable state laws governing the investment of public funds have been reviewed and are being followed.

The PDA would like to note that although the investments in question did not meet the requirements of state law, investments were insured by the FDIC up to \$100,000 per investment. The GHPDA, with the consent of the State Auditor's Office, is continuing to hold these investments until their normal maturity dates in order to avoid costly penalties and preserve the existing interest rates procured at the time of acquisition. After the current CEO was made aware of this issue (through the process of this audit), as these investments have matured the proceeds have been invested in instruments that comply with state law. The PDA will continue to do so.

Auditor's Remarks

We appreciate that the PDA concurs with our audit recommendations and has taken measures to address the areas of concern. We will follow up on the new procedures during our next audit.

Applicable Laws and Regulations

RCW 39.58.080 Deposits of public funds in public depository required states in part:

. . . no public funds shall be deposited in demand or investment deposits, except in a public depository located in this state or as otherwise expressly permitted by statute

Schedule of Audit Findings

Grays Harbor Public Development Authority Grays Harbor County January 1, 1999 through December 31, 2000

5. The Authority does not have adequate internal controls over payroll expenditures for leave.

Background

During the audit period, nine employees left the Authority's employment. We reviewed final payroll information for each of the nine and found that the Authority cashed out a total of \$75,518.28 in leave that had not been taken. When we recalculated the cash-outs based on information in offer of employment letters, we determined the amount should have been \$39,646, a difference of \$35,872. Of the nine calculations reviewed, only two had been done correctly.

Description of Condition

During our review of payroll systems, we noted a general lack of policies and procedures. No system was in place to ensure employees leaving the Authority were paid only for leave that they had earned.

The Authority documents each offer of employment and the terms in a letter. The Authority negotiates the number of paid days off at the onset of employment. The number of days off ranged from 15 to 70. These days were to be used between the hire date and first anniversary date of hire. The employment letter also states the employee will accrue leave each month at a rate equal to what was negotiated at the time of his or her employment. Those days may be used after the first anniversary date.

Our review showed that employees who left the Authority prior to their first anniversary date of hire were paid for the balance of their initial leave and the amount they had accrued. In one instance, this amount was \$17,000.

Cause of Condition

The Authority lacks adequate internal controls and policies and procedures specific to leave buyouts in the payroll process. Management stated that because no policy was in place regarding this issue, they decided to award the cash-out as described above. Management stated that they used that precedent to process subsequent buyouts.

Effect of Condition

The lack of internal controls and policies specifically addressing leave cash-outs resulted in expenditures greater than necessary.

Recommendations

We recommend the Authority improve internal controls and establish written policies and procedures governing payroll, specifically addressing leave cash-outs.

Authority's Response

The GHPDA Board of Directors formally adopted a comprehensive benefits policy in 2001. The new policy became effective January 1, 2002. The policy clearly defines the rules relating to the accrual and payment of the PTO (paid time off) benefit.

Auditor's Remarks

We appreciate that the Authority concurs with our audit recommendations and has taken measures to address the areas of concern. We will follow up on the new policy during our next audit.

Applicable Laws and Regulations

The Authority's offer of employment letter states in part:

The employee will be front loaded with paid vacation days to be used between the start date and the first anniversary date. During the first year the employee will be accruing paid vacation at a rate equal to the amount of the front load. These days may be used after the first anniversary date.

Volume I, Part 3, Chapter 1, page 7 of the *Budgeting, Accounting and Reporting System* (BARS) manual, issued by the State Auditor's Office pursuant to RCW 43.09.230, states in part:

An internal control system consists of the plan of organization and methods and procedures adopted by management to ensure that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

The ultimate responsibility for good internal controls rests with management.